



Entergy

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Little Rock, AR 72203  
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TN REGULATORY AUTHORITY  
DOCKET ROOM

November 21, 2002

Ms. Sara Kyle, Chairman  
Tennessee Regulatory Authority  
460 James Robertson Parkway  
Nashville, TN 37243-0505

Re: Tennessee Regulatory Authority (TRA) Docket No. 02-01216  
Entergy Arkansas, Inc. Application for Approval of Synthetic  
Railcar Lease

Dear Chairman Kyle:

As mentioned in our letter of November 21, attached are an original and thirteen copies of the Arkansas Public Service Commission (APSC) Staff Testimony of Johnny Brown filed November 19 in APSC Docket No. 02-224-U recommending approval of EAI's Application and synthetic railcar lease.

Also attached is an original and thirteen copies of APSC Order No. 1 issued in APSC Docket No. 02-224-U on November 20, 2002, granting EAI's Application and approving the proposed Synthetic Lease.

The lease is expected to close in the first week of December; therefore, EAI would appreciate inclusion of this matter in the December 2, 2002, TRA conference agenda.

If you have any questions or need additional information, please do not hesitate to call me at (501) 377-5489.

Sincerely,

William R. Morgan  
Manager, Regulatory Affairs

WM/tj  
Attachments

ARK PUBLIC S. COMM.  
DI. ON  
SECRETARY COMM.

BEFORE THE ARKANSAS PUBLIC SERVICE COMMISSION  
Nov 19 2 34 PM '02

FILED

IN THE MATTER OF THE APPLICATION  
OF ENTERGY ARKANSAS, INC. FOR  
APPROVAL OF SYNTHETIC RAILCAR  
LEASE

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DOCKET NO. 02-224-U

PREPARED TESTIMONY

OF

JOHNNY BROWN  
FINANCIAL ANALYST

ON BEHALF OF THE  
ARKANSAS PUBLIC SERVICE COMMISSION GENERAL STAFF

NOVEMBER 19, 2002

**BIOGRAPHY**

1

2 **Q. Please state your name and business address.**

3 A. My name is Johnny Brown. My business address is the Arkansas Public Service  
4 Commission (Commission or APSC), 1000 Center Street, Little Rock, Arkansas,  
5 72201.

6 **Q. Please describe your present position with the Arkansas Public Service Commission**  
7 **General Staff (Staff).**

8 A. I am employed by Staff as a Financial Analyst in the Financial Analysis Section. In that  
9 capacity I perform economic and financial analysis, including determining the  
10 appropriate relative relationship between debt and equity capital and calculating the cost  
11 of debt, preferred stock and common equity as components for determining the overall  
12 required rate of return for jurisdictional utilities. Additionally, I evaluate proposed debt  
13 and equity issuances, mergers, and acquisitions pertaining to the Arkansas jurisdiction,  
14 and monitor current economic and market trends and their impact on the cost of capital.

15 **Q. Please describe your education, work experience, and qualifications.**

16 A. I graduated from the University of Arkansas at Little Rock in May of 2001 with a  
17 Bachelor of Business Administration degree in Finance. For two years during and after  
18 college I worked in the financial services industry as assistant to the investment manager  
19 at a local investment management firm. My duties consisted of securities analysis,  
20 portfolio modeling, compiling and reporting the financial statements of the company,  
21 quarterly billing, and managing the monthly payroll tax withholdings. As my experience  
22 progressed, my responsibilities were expanded to include the evaluation of investment

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DOCKET NO. 02-224-U

1 portfolios to ensure that valuation and performance characteristics were maintained based  
2 on the personal needs of the client and other economic and financial factors.

3 Additionally, I was heavily involved in the fundamental and technical analysis used to  
4 evaluate capital markets and specific securities in order to make informed investment  
5 decisions.

6 During the time I have been employed by Staff I have attended several regulatory  
7 training seminars, including the NARUC Annual Regulatory Studies Program at  
8 Michigan State University, and the Utility Regulatory Training presented by the Center  
9 for Public Utilities of New Mexico State University. I have also recently attended the  
10 annual Financial Forum sponsored by the Society of Utility and Regulatory Financial  
11 Analysts, of which I am a member.

12 **PURPOSE**

13 **Q. What is the purpose of your testimony in this proceeding?**

14 A. My testimony will address the lease structure proposed by Entergy Arkansas, Inc. (EAI  
15 or Company) in its Application filed on November 6, 2002, concerning the financing  
16 arrangements necessary to replace its former lease of aluminum railcars that are used to  
17 transport coal for use as fuel at the White Bluff Steam Electric Station and the  
18 Independence Steam Electric Station.

19 **Q. Briefly describe the Company's proposal?**

20 A. As described in the Application and the Direct Testimony of Company witnesses Mr.  
21 Steven C. McNeal and Mr. Jeffrey G. Herndon, EAI is proposing the use of a  
22 Synthetic Lease to replace the lease that has been financing its existing fleet of

ENTERGY ARKANSAS, INC.  
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DOCKET NO. 02-224-U

1 aluminum railcars. The equipment leased will be approximately 2,545 aluminum  
2 rotary-dump high-side gondola railcars with an estimated cost of approximately  
3 \$78,000,000. The basic term of the proposed financing is expected to begin in late  
4 November or early December 2002, and will have an initial term of five years, with  
5 EAI holding an option to renew the lease for two consecutive one-year terms.

6 The basic quarterly rent payments under the lease will vary in amount and will  
7 be calculated based upon an amortization of the cost of the equipment plus the  
8 associated interest. The interest rate associated with the proposed financing will be set  
9 at the 3-month London Interbank Offered Rate (LIBOR) plus 175 basis points, which is  
10 swapped to a 7-year fixed rate through an interest rate swap.

11 **Q. Did the Company identify advantages the proposed financing has over other options**  
12 **available?**

13 **A.** Yes. Mr. Herndon on pages 6 through 8 of his Direct Testimony and Mr. McNeal on  
14 pages 5 and 6 of his Direct Testimony describe several advantages offered by the  
15 proposed financing versus an outright purchase and a traditional leveraged lease. The  
16 main advantages over the purchase option are the increased flexibility that the lease  
17 provides, and the approximately \$24 million net present value savings to the customer  
18 according to the Company's calculations. The advantages over the leveraged lease  
19 format include Entergy's continuing right to renew, terminate, or return the equipment  
20 without the usual premiums penalties, or outright prohibition normally associated with a  
21 leveraged lease; a lower short-term interest rate; a less complicated financial instrument  
22 resulting in lower transaction and administrative costs; as well as income tax advantages.

ENTERGY ARKANSAS, INC.  
PREPARED TESTIMONY OF JOHNNY BROWN  
DOCKET NO. 02-224-U

1    **Q.    What kind of accounting treatment will the Company use?**

2    A.    The accounting treatment will be the same treatment approved in Order No. 2 of Docket  
3       No. 94-439-U.

4    **Q.    What are your recommendations concerning EAI's proposed financing?**

5    A.    As calculated by the Company, the proposed financing produces significant fuel cost  
6       savings, with respect to the other financing options available. These savings will be  
7       passed on to EAI's customers on a current basis through the Fuel Adjustment Clause. In  
8       addition, the proposed financing agreement will provide the greatest flexibility for the  
9       Company to take advantage of future opportunities in the capital markets and the railcar  
10       transportation market. Therefore, I recommend that the use of the proposed Synthetic  
11       Lease to finance EAI's fleet of 2,545 railcars be approved. Nothing in my testimony in  
12       this docket represents a finding of value for ratemaking purposes, and I recommend that  
13       the Commission reserve the right to examine the appropriateness of any financing costs  
14       in the context of a rate case.

15   **Q.    Do you have any recommendations for reporting to the Commission?**

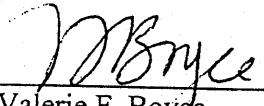
16   A.    Yes. The Company indicated in its Application that certain provisions of the lease  
17       agreement were still being negotiated at the time of filing. Staff recommends that EAI  
18       file the finalized lease agreement in Docket No. 86-033-A referencing the instant docket.

19   **Q.    Does this conclude your testimony?**

20   A.    Yes.

### CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Testimony has been served on all parties of record by forwarding the same by first-class mail, postage prepaid, this 19<sup>th</sup> day of November, 2002.

  
Valerie F. Boyce

Nov 21 12 34 PM '02

ARKANSAS PUBLIC SERVICE COMMISSION

FILED

IN THE MATTER OF THE APPLICATION OF )  
ENTERGY ARKANSAS, INC. FOR APPROVAL OF )  
SYNTHETIC RAILCAR LEASE )

DOCKET NO. 02-224-U  
ORDER NO. 1

ORDER

On November 6, 2002, Entergy Arkansas, Inc. ("EAI") filed in the above-styled docket an *Application For Approval Of Synthetic Railcar Lease* ("Application") pursuant to Ark. Code Ann. §23-3-104 and Sections 4 and 5 of the Commission's *Rules of Practice and Procedure* ("Rules"). Attached as EAI Exhibit A to said Application was the *Synthetic Lease Agreement* (the "Synthetic Lease") for which EAI seeks approval. Filed in support of its Application were the Direct Testimonies of Jeffrey G. Herndon and Steven C. McNeal. EAI requested that the Commission expedite consideration of its Application and enter a final order thereon on or before November 22, 2002.

The subject matter of EAI's Application is an anticipated lease to replace EAI's former lease for the aluminum railcars that are used to transport coal for use as fuel at the White Bluff Steam Electric Station and the Independence Steam Electric Station, which are co-owned by EAI and other providers of electric service. In Order No. 4, issued on June 7, 1995, in Docket No. 94-439-U, the Commission initially approved a "Hybrid Lease" to finance the railcars. The Hybrid Lease approved by Order No. 4 had an initial term of one year, beginning in October 1995, and was renewable for six consecutive one-year terms. EAI exercised all its options to extend the Hybrid Lease, but it has



now expired, thus creating the need for new financing arrangements.

The Hybrid Lease approved in Docket No. 94-439-U was so named because while for accounting purposes, it was treated as an operating lease, for tax purposes EAI was treated as the owner of the equipment. Rent expense under the lease was composed of fixed rent, which corresponded to an amortization amount, plus variable rent, which corresponded to interest on the unamortized amount.

As described in the Direct Testimonies of EAI witnesses Herndon and McNeal, EAI has been able to negotiate terms for a new Synthetic Lease which is similar to the Hybrid Lease approved by the Commission in Docket No. 94-439-U. As did the earlier lease, the new lease structure has characteristics associated with both operating and capital leases that will permit EAI to enjoy substantial cost savings. For financial accounting and reporting purposes, the Synthetic Lease will be structured so as to constitute an operating lease under SFAS No. 123, as amended. However, for all other purposes, including tax purposes, EAI will be considered to be the owner of the railcars. Certain of the Synthetic Lease terms may be amended or modified, from time to time, in order to comply with future accounting standards which may be applicable to the Synthetic Lease.

EAI proposes to enter into the Synthetic Lease with the BTM Capital Corporation. The equipment leased will be approximately 2,545 aluminum rotary dump high side gondola railcars with an estimated cost of approximately \$78,000,000. The Synthetic Lease is anticipated to commence in late November or early December 2002, and will have an initial term of five years, with EAI holding an option to renew the lease for two consecutive one-year terms.

EAI's rental payments will be made quarterly and will be based upon a Lease Amortization component, which is a fixed amount and corresponds to an amortization amount, and a Lease Rate

component, which is a variable amount and corresponds to interest on the unamortized amount. During the Initial Lease Term, the Lease Rate is expected to be equal to 3-month London Interbank Offered Rate plus 175 basis points and will be adjusted for EAI based on senior unsecured long-term debt ratings by Standard & Poor's Corporation and Moody's Investor Service, Inc. However, EAI expects to fix the variable amount of the Lease Rate over the entire term of the Synthetic Lease by means of a seven-year interest rate swap arrangement. The lease will be amortized over the Maximum Lease Term to a final lease balance of 55 percent.

As described by Mr. Herndon, the projected economic value of the Synthetic Lease to EAI and its customers is greater than that of the potential alternatives. Mr. Herndon compared the costs, beginning in 2002 and extending for 21 years, of purchasing the railcars, executing an Operating Lease, or executing a Synthetic Lease. In all the scenarios in which the railcar costs are reflected in EAI's rates, which was permitted for the Hybrid Lease by Orders No. 2 and 4 of Docket No. 94-439-U, the Synthetic Lease is projected to produce net present value savings to ratepayers of approximately \$24 million, as compared to the purchase option, and approximately \$19 million as compared to an Operating Lease.

Due to the similarity in the structure of the Hybrid Lease and the Synthetic Lease, EAI intends to account for the rental payments under the Synthetic Lease as fuel expense, which was permitted for the Hybrid Lease under Orders No. 2 and 4 of Docket No. 94-439-U. Accordingly, the proposed transaction has no impact on EAI's balance sheet.

Closing of the anticipated transaction is scheduled to take place in late November or early December 2002. As a result, EAI requests the Commission expedite action on this Application and enter a final order thereon on or before November 22, 2002 so that EAI's customers and its co-

owners in the coal plants can begin to realize the fuel cost efficiencies associated with the use of the new financing arrangements at the earliest possible date.

On November 19, 2002, the General Staff of the Commission ("Staff") filed the Prepared Testimony of Johnny Brown in response to EAI's Application. Therein, Mr. Brown testified that the main advantages of the Synthetic Lease over the purchase option are the increased flexibility that the lease provides, and the approximately \$24 million net present value savings to EAI's customers. The advantages over the leveraged lease format include EAI's continuing right to renew, terminate, or return the equipment without the usual premiums penalties, or outright prohibition normally associated with a leveraged lease; a lower short-term interest rate; a less complicated financial instrument resulting in lower transaction and administrative costs; as well as income tax advantages.

As calculated by EAI, the proposed Synthetic Lease financing produces significant fuel cost savings, with respect to the other financing options available. These savings will be passed on to EAI's customers on a current basis through EAI's Fuel Adjustment Clause. In addition, the proposed Synthetic Lease financing agreement will provide the greatest flexibility for EAI to take advantage of future opportunities in the capital markets and the railcar transportation market. Accordingly, Mr. Brown recommended that the use of the proposed Synthetic Lease to finance EAI's fleet of 2,545 railcars be approved.

Based upon the referenced testimonies and Mr. Brown's recommendation, the Commission finds and directs as follows:

1. EAI's November 6, 2002, Application is granted and the proposed Synthetic Lease Agreement, attached as EAI Exhibit A to the Application, is approved.
2. The accounting treatment of the Synthetic Lease Agreement shall be the same as

approved in Docket No. 94-439-U.

3. A finalized and executed copy of the Synthetic Lease Agreement shall be filed in Docket No. 86-033-A referencing the instant docket.

4. The Commission specifically reserves the right to examine the appropriateness of any financing costs associated with execution of the Synthetic Lease Agreement in the context of EAI's next rate case.

BY ORDER OF THE COMMISSION.

This 21<sup>st</sup> day of November, 2002.

*Sandra L. Hochstetter*  
Sandra L. Hochstetter, Chairman

*Betty C. Dickey*  
Betty C. Dickey, Commissioner

*Daryl E. Bassett*  
Daryl E. Bassett, Commissioner

*Diana K. Wilson*  
Diana K. Wilson  
Secretary of the Commission

I hereby certify that the following order issued by the Arkansas Public Service Commission has been served on all parties of record this date by U.S. mail with postage prepaid, using the address of each party as indicated in the official docket file.

*Diana K. Wilson*  
Diana K. Wilson  
Secretary of the Commission  
Date 11-21-02